

REPORT OF THE AUDITOR-GENERAL TO THE LIMPOPO PROVINCIAL LEGISLATURE AND THE COUNCIL ON EPHRAIM MOGALE LOCAL MUNICIPALITY

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of Ephraim Mogale Local Municipality set out on pages xx to xx, which comprise the statement of financial position as at 30 June 2012, the statement of financial performance, statement of changes in net assets and the cash flow statement for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2010 (Act No. 1 of 2010) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-General's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the *General Notice* issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
4. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for Qualified opinion

Investment property

5. The municipality did not determine the fair value of investment property accounted for under the fair value model, in accordance with Standards of Generally Recognised Accounting Practice, GRAP 16, *Investment Properties*. Furthermore not all investment property registered in the name of the municipality could be traced to the asset register of the municipality. The municipality's records did not permit the application of alternative

procedures. Consequently I could not satisfy myself as to the valuation, allocation and completeness of investment property of R63 917 414 as disclosed in note 3 to the financial statements

Property plant and equipment (PPE)

6. I was unable to obtain sufficient appropriate audit evidence for an amount of R2 648 136 of additions included in property, plant and equipment balance of R778 310 998 disclosed in note 4 to the financial statement. The municipality's records did not permit the application of alternative procedures. Consequently I was unable to determine whether any adjustments relating to property plant and equipment in the financial statements was necessary.
7. Standards of Generally Recognised Accounting Practice, GRAP 17: *Property Plant and Equipment*, GRAP 17 requires that where an asset is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition. The municipality did not value land of R865 300 at acquisition included in land and buildings of R28 839 539 at fair value as required in terms of GRAP 17. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation of land and buildings.
8. The municipality capitalised work in progress of R504 061 relating to projects that was not complete as property, plant and equipment. Consequently property, plant and equipment as disclosed is overstated and work in progress is under stated by R504 061.
9. The nature of the municipality's accounting records did not facilitate an easy identification and location of assets recorded in the financial statements. There were a significant number of assets which I identified that were not included in the accounting records of the municipality and not all land registered in the name of the municipality could be traced to the asset register of the municipality. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the existence, valuation and allocation and completeness of the tangible capital assets stated at R778 310 998 (2011: R795 826 873) in the financial statements

Depreciation

10. Standards of Generally Recognised Accounting Practice, GRAP 17: *Property Plant and Equipment* describes land and buildings as separable assets and is accounted separately, even when they are acquired together. The municipality did not account for land and buildings separately in note 4 to the financial statements as required by GRAP 17. Furthermore GRAP 17 states that land has an unlimited useful life and therefore is not depreciated. Contrary to the requirements of the SA Standards of GRAP 17, the municipality has depreciated land by R1 608 500. Consequently, depreciation as disclosed in note 29 to the financial statements is overstated by R1 608 500 and land is understated by the same amount.
11. The municipality did not accurately calculate the depreciation on property, plant and equipment for the current year. I have recalculated the depreciation for the current year and a misstatement was identified. Depreciation as disclosed of R35 882 761 is overstated by R724 200. Consequently, I could not verify the accuracy of depreciation for the current year as disclosed in note 29 to the financial statements.

Commitments

12. No contract management system was in place for the identification and recognition of contracts and there were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all commitments were properly recorded. Consequently, I

was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of commitments of R9 265 454, as stated in note 43 to the financial statements. Furthermore the municipality incorrectly included Value Added Tax VAT receivable (2011: R1 531 241) and VAT payable of R873 785 as commitments.

Payables from exchange transactions

13. Included in Trade and other payables of R14 947 198 as disclosed in note 14 to the financial statements is expenditure of R4 263 440 that has been recognised excluding value added tax (VAT) trade and other payables is understated and expenditure is overstated by R556 670. Furthermore leave provision has been calculated incorrectly and is understated by R709 467 as the incorrect leave days were used during the calculation. Consequently I did not obtain sufficient appropriate audit evidence to satisfy myself as to the valuation and existence of payables from exchange transactions as disclosed in the financial statements.
14. The municipality did not accrue for invoices in respect of goods and services received amounting to R1 508 582. Had these invoices been accrued for, the effect would have been to reduce the surplus for the period and the accumulated surpluses by R1 508 582 and to increase the accrued liability in the statement of financial position by an equal amount.
15. The municipality could not provide sufficient appropriate audit evidence for the amount of R846 970 identified as a misstatement in the prior period. Consequently I was unable to determine whether any adjustment relating to trade and other payables in the financial statements was necessary.

Expenditure

16. The municipality could not provide sufficient appropriate audit evidence to support payments of R310 152 in respect of goods and services. There were no satisfactory alternative audit procedures that I could perform to obtain reasonable assurance that all goods and services were properly recorded. Consequently, I did not obtain sufficient appropriate audit evidence to satisfy myself as to the occurrence, and accuracy of goods and services.

Value Added Tax (VAT)

17. The municipality entered into an agency agreement with its district municipality for the provision of water services. As the agent, the municipality has accounted for VAT on the water transactions in contravention with the VAT Act. The municipality also entered in to an agency agreement with the department of roads and transport for the collecting of license fees and issuing licenses and permits on behalf of the provincial government. The municipality did not account for output tax on the commission or agency fees for the services rendered in contravention with VAT act. Furthermore there were unexplained differences between the VAT returns, the amount disclosed in the financial statements and the amount accounted for in the general ledger. The municipality's records did not permit the application of alternative procedures regarding the VAT disclosed in the financial statements. Consequently, I was unable to determine the correct amount of the VAT payable balance of R873 785 (2012) and VAT receivable balance of R1 531 241 (2011) as disclosed in note 15 and 9 to the financial statements.

Irregular expenditure

18. Section 125(2)(d) of the MFMA requires the municipality to implement and maintain an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective. Payments amounting to R61 892 928 were made in contravention of the supply chain management requirements and was not disclosed note 44

to the financial statements. Furthermore, the municipality could not provide sufficient appropriate audit evidence to prove that the allocation of contracts amounting to R44 286 737 were awarded in accordance with supply chain management regulations. Consequently, I was unable to obtain sufficient appropriate audit evidence to satisfy myself as to the completeness of irregular expenditure.

Employee related costs

19. Employee related costs of R47 364 117 as disclosed in note 24 to the financial statements does not agree to the balance of R470 603 306 per the underlying accounting records. The agency did not reconcile the difference of R303 808 between the financial statements and the underlying records. Consequently, employee related costs are understated by R303 808.
20. I was unable to obtain sufficient appropriate audit evidence for an amount of R259 930 included in the employee related costs. The municipality's records did not permit the application of alternative procedures. Consequently I was unable to determine whether any adjustment relating to employee related costs in the financial statements was necessary.

Unspent conditional grants

21. I was unable to obtain sufficient appropriate audit evidence for an amount of R656 089 between the conditional grant expenditure of R12 798 849 recognised in the general ledger and the amount of R12 742 762 recognised as revenue. The municipality did not perform a reconciliation to determine the effect of the reconciling items and consequently could not provide explanations for the reconciling difference of R656 089. Consequently I could not satisfy myself as to the accuracy of unspent conditional grants as disclosed.

Opinion

22. In my opinion, except for the possible effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Ephraim Mogale Local municipality as at 30 June 2012, and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

23. I draw attention to the matters below. My opinion is not modified in respect of these matters

Restatement of corresponding figures

24. As disclosed in note 36 to the financial statements, the corresponding figures for 30 June 2011 have been restated as a result of an error discovered during 2012 in the financial statements of the Ephraim Mogale Local Municipality at, and for the year ended, 30 June 2011.

Material impairments

25. As disclosed in note 10 to the financial statements, material impairments to the amount of R17 378 275 were incurred as a result of impairment of irrecoverable trade debtors.

Unauthorised expenditure

26. The municipality incurred unauthorised expenditure of R37 491 261 as disclosed in note 40 due to overspending of the budget.

Additional matter

27. I draw attention to the matters below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

28. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

29. In accordance with the PAA and the *General Notice* issued in terms thereof, I report the following findings relevant to performance against predetermined objectives, compliance with laws and regulations and internal control, but not for the purpose of expressing an opinion.

Predetermined objectives

30. I performed procedures to obtain evidence about the usefulness and reliability of the information in the annual performance report as set out on pages XX to XX of the annual report.
31. The reported performance against predetermined objectives was evaluated against the overall criteria of usefulness and reliability. The usefulness of information in the annual performance report relates to whether it is presented in accordance with the National Treasury annual reporting principles and whether the reported performance is consistent with the planned development priorities or objectives. The usefulness of information further relates to whether indicators and targets are measurable (i.e. well defined, verifiable, specific, measurable and time bound) and relevant as required by the *National Treasury Framework for managing programme performance information (FMPPi)*.

The reliability of the information in respect of the selected development priorities is assessed to determine whether it adequately reflects the facts (i.e. whether it is valid, accurate and complete).

32. The material findings are as follows:

Usefulness of information

Presentation

Measures to improve performance not disclosed

33. Improvement measures in the annual performance report for a total of 100% of the planned targets of Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management not achieved were not disclosed as required by section 46 of the Municipal Systems Act (MSA). This was due to inadequate internal policies and procedures over the processes pertaining to the reporting of performance information.

Consistency

Reported objectives, indicators and targets not consistent with planned objectives, indicators and targets

34. The MSA section 41(c) requires that the actual achievements against all planned indicators and targets must be reported annually. The annual performance report submitted for audit purposes did not include the actual performance of 100% of Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets

and Financial management objectives specified in the integrated development plan for the year under review. This was due to lack of monitoring of the completeness of reporting documents by management.

Measurability

Performance targets not specific

35. The National Treasury *FMPPI* requires that performance targets be specific in clearly identifying the nature and required level of performance. 100% of the targets relevant to Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management objectives were not specific in clearly identifying the nature and the required level of performance. This was due to the fact that management was aware of the requirements of the *FMPPI* but chose not to apply the principles contained in the *FMPPI*.

Performance targets not measurable

36. The National Treasury *FMPPI* requires that performance targets be measurable. The required performance could not be measured for a total of 100% of the targets relevant to Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management objectives. This was due to the fact that management was aware of the requirements of the *FMPPI* but chose not to apply the principles contained in the *FMPPI*.

Performance targets not time bound

37. The National Treasury *FMPPI* requires that the time period or deadline for delivery be specified. A total of 100% of the targets relevant to Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management objectives were not time bound in specifying a time period or deadline for delivery. This was due to the fact that management was aware of the requirements of the *FMPPI* but chose not to apply the principles contained in the *FMPPI*.

Performance indicators not well defined

38. The National Treasury *FMPPI* requires that indicators should have clear unambiguous data definitions so that data is collected consistently and is easy to understand and use. A total of 100% of the indicators relevant to Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management objectives were not well defined in that clear, unambiguous data definitions were not available to allow for data to be collected consistently. This was due to the fact that management was aware of the requirements of the *FMPPI* but chose not to apply the principles contained in the *FMPPI*.

Performance indicators not verifiable

39. The National Treasury *FMPPI* requires that it must be possible to validate the processes and systems that produce the indicator. A total of 100% of the indicators relevant to Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management objectives were not verifiable in that

valid processes and systems that produce the information on actual performance did not exist. This was due to the fact that management was aware of the requirements of the *FMPPI* but chose not to apply the principles contained in the *FMPPI*.

Relevance

Performance indicators not relevant

40. The National Treasury *FMPPI* requires that the indicator should relate logically and directly to an aspect of the institution's mandate, the realisation of strategic goals and objectives. A total of 100% of indicators of Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management did not relate logically and directly to an aspect of the institution's mandate and realisation of strategic goals and objectives as per the integrated development plan. This was due to the lack of development and implementation of proper performance planning and management practices to provide for the development of performance indicators and targets included in the annual integrated development plan. There were no indicators or targets included in the integrated development plan or service delivery budget implementation plan.

Reliability of information

Reported performance not valid

41. The National Treasury *FMPPI* requires that processes and systems which produce the indicator should be verifiable. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the validity of the actual reported performance relevant to 100% of Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management objectives. This was due to limitations placed on the scope of my work due to the municipality's records not permitting the application of alternative audit procedures.

Reported performance not complete

42. The National Treasury *FMPPI* requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of the actual reported performance relevant to 100% of Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management objectives. This was due to limitations placed on the scope of my work by the absence of the municipality's records not permitting the application of alternative audit procedures.

Reported performance not Validity Accuracy

43. The National Treasury *FMPPI* requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of the actual reported performance relevant to 100% of Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management objectives. This was

due to limitations placed on the scope of my work by the absence of the institution's records not permitting the application of alternative audit procedures.

Reported performance not Validity Completeness

44. The National Treasury *FMPPI* requires that documentation addressing the systems and processes for identifying, collecting, collating, verifying and storing information be properly maintained. I was unable to obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of the actual reported performance relevant to 100% of Water infrastructure, Sanitation, Electricity, Road and storm water, Waste management and refusal disposal, Local development and job creation, Education, Organizational infrastructure and assets and Financial management objectives. This was due to limitations placed on the scope of my work by the absence of the institution's records not permitting the application of alternative audit procedures.

Compliance with laws and regulations

45. I performed procedures to obtain evidence that the entity has complied with applicable laws and regulations regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key applicable laws and regulations as set out in the *General Notice* issued in terms of the PAA are as follows:

Expenditure management

46. The accounting officer did not take effective steps to prevent unauthorised, irregular and fruitless and wasteful expenditure, as per the requirements of section 62(1)(d) of the MFMA.
47. Money owing by the municipality was not always paid within 30 days of receiving an invoice or statement, as required by section 65(2)(e) of the MFMA.

Annual financial statements, performance and annual report

48. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act. Material misstatements of current assets, liabilities, expenditure, disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
49. The annual performance report for the year under review does not include the performance of the municipality and a comparison with the previous financial year and measures taken to improve performance, as required by section 46 (1)(a) of the Municipal Systems Act.

Procurement and contract management

50. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of SCM Regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.
51. Sufficient appropriate audit evidence could not be obtained that bids were evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).

52. Bid specifications were not always drafted by bid specification committees which were composed of one or more officials of the municipality as required by SCM regulation 27(3).
53. Sufficient appropriate audit evidence could not be obtained that bid adjudication was always done by committees which were composed in accordance with SCM regulation 29(2).
54. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value of below R200 000 were procured by means of obtaining the required price quotations, as required by SCM regulation 17(a) & (c).
55. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of 14 days, as required by SCM regulation 22(1) & 22(2).
56. Sufficient appropriate audit evidence could not be obtained that construction contracts were awarded to contractors that were registered with the Construction Industry Development Board (CIDB) and qualified for the contract in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).

Asset Management

57. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.

Strategic and performance management

58. The municipality did not give effect to its integrated development plan, as required by section 36 of the MSA and Municipal planning and performance management regulation 6.
59. The municipal council did not review its integrated development plan annually in accordance with an assessment of its performance measurements in terms of section 41 and to the extent that changing circumstances demanded, as required by section 34 of the MSA and Municipal Planning and Performance Management Regulation 3.
60. The municipality did not establish a performance management system in line with the priorities, objectives, indicators and targets contained in its integrated development plan and did not clarify the roles and responsibilities of each role-player in the functioning of the system and did not determine the frequency of reporting and the lines of accountability for performance and did not relate to the municipality's performance management processes and did not provide for procedures by which the system is linked to the municipality's integrated development planning processes, as required by section 38 (a) of the Municipal Systems Act and Municipal Planning and Performance Management Regulation 7(2)(c/e/f/g).
61. The municipality did not establish mechanisms to monitor and review its performance management system, as required by section 40 of the MSA.
62. The municipality did not set appropriate key performance indicators as a yardstick for measuring performance, including outcomes and impact, with regard to the municipality's development priorities and objectives set out in its integrated development plan, set measurable performance targets with regard to each development priority and objective, monitor performance, with regard to each of those development priorities and objectives and against the key performance indicators and targets set and measure and review performance at least once per year, with regard to each of those development priorities and objectives and against the key performance indicators and targets set and take steps to

improve performance with regard to those development priorities and objectives where performance targets are not met as required by section 41 of the MSA.

Audit committee

63. The audit committee did not meet at least four times a year, as required by section 166(4)(b) of the MFMA.

Internal audit

64. An internal audit unit was established, as required by section 165(1) of the Municipal Finance Management Act and was not fully capacitated.

INTERNAL CONTROL

65. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with laws and regulations. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with laws and regulations included in this report.

Leadership

66. Management does not always appropriately provide the required supervision and review over operations to ensure that the municipality complies with all laws and regulations and appoint the necessary skilled staff members. Action plans were developed, *however*, they were not fully implemented, hence the recurrence of findings identified in the prior year with regard to asset management and water related transactions not adequately monitored and reconciled frequently.

Financial and performance management

67. The municipal managers position and the chief financial officer's position has been vacant for 12 months. Due to the fact that various persons were acting in these positions during the financial year, the following deficiencies were identified:
- Proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting was not implemented.
 - Regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information was not implemented.
 - Design and implementation of formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information was not implemented.

Governance

68. Management ineffectiveness in implementing recommendations from internal audit and external audit prevented the audit committee from promoting accountability and service delivery through evaluating and monitoring responses to risk and providing oversight over the effectiveness of the internal control environment, including financial and performance reporting and compliance.

Polokwane

18 December 2012



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence